Supreme Court's 2009-2010 term sets up showdown over class-action waivers in arbitration agreements

By Gail L. Westover, Esq., Wilson G. Barmeyer, Esq., and Brendan Ballard, Esq.

Not only did the Supreme Court's 2009-2010 term continue the trend in favor of arbitration, but it also set up a key showdown for next term regarding the enforceability of class-action waivers in arbitration agreements and the extent to which the Federal Arbitration Act preempts state contract law.

In three decisions issued last spring, the court took positions that appear to strengthen the hands of parties who wish to avoid class action litigation by including arbitration provisions in contracts for consumer products, financial services and employment:

- First, the Supreme Court held in *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*, 130 S. Ct. 1758 (Apr. 27, 2010), that class arbitration cannot be imposed on parties whose arbitration agreement is silent on the issue.
- Second, in *American Express Co. v. Italian Colors Restaurant*, 130 S. Ct. 2401 (Mem.) (May 3, 2010), the Supreme Court vacated a judgment of the 2nd U.S. Circuit Court of Appeals that held a class-action waiver was unenforceable. The Supreme Court issued its decision without opinion and remanded the case to the 2nd Circuit for reconsideration in light of *Stolt-Nielsen*.
- Third, the Supreme Court held in *Rent-A-Center West v. Jackson*, 130 S. Ct. 2772 (June 21, 2010), that if the parties' agreement has clearly delegated the task, the arbitrator should decide when an arbitration provision is unconscionable.

Finally, and perhaps most significantly, the Supreme Court granted *certiorari* in *AT&T Mobility LLC v. Concepcion,* 130 S. Ct. 3322 (May 24, 2010), to address whether the Federal Arbitration Act preempts state law rules limiting the enforceability of arbitration agreements. In *Concepcion*, which is scheduled for oral argument Nov. 9, the justices will specifically consider whether the FAA preempts California state court rulings that class-action waivers are unconscionable in consumer arbitration agreements as a matter of public policy. Because courts in many states have held that the waivers may be found unconscionable under state contract law principles, the Supreme Court's decision has the potential to mark a significant shift in the arbitration arena.

STOLT-NIELSEN V. ANIMALFEEDS

In a 5-3 majority decision issued April 27 the U.S. Supreme Court held in *Stolt-Nielsen S.A. v. AnimalFeeds* that imposing class arbitration on parties who have not agreed specifically to it is inconsistent with the FAA, 9 U.S.C. § 1. Because the parties stipulated that the arbitration clause was silent on class arbitration, the Supreme Court held that the arbitration panel exceeded its powers by inferring the parties intended to authorize class-wide arbitration. The holding answered the question left open by *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444 (June 23, 2003), on the proper standard to be applied in deciding whether class arbitration is permitted.

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AnimalFeeds brought an antitrust class action in federal court against Stolt-Nielsen for price-fixing. The parties had entered into an arbitration agreement, but it was silent on the issue of class arbitration. The action was ordered to arbitration, and the parties agreed to submit to a panel of arbitrators the question of whether their arbitration agreement allowed for class arbitration. The panel determined that the arbitration clause allowed for class-wide arbitration.

The U.S. District Court for the Southern District of New York vacated that determination on the ground that it was made in manifest disregard of the law. 435 F. Supp. 2d 382 (S.D.N.Y. 2006). On appeal, the 2nd Circuit reversed, upholding the arbitrators' ruling compelling class arbitration and rejecting Stolt-Nielsen's argument that the FAA precludes the imposition of class arbitration unless it is expressly provided for in the arbitration agreement. 548 F.3d 85, 100-01 (2d Cir. 2008). The Supreme Court granted Stolt-Nielsen's petition for a writ of *certiorari* June 15, 2009.

In the majority opinion, authored by Justice Samuel Alito, the court noted that the arbitration panel exceeded its powers by imposing its own policy preference instead of identifying and applying a rule of decision derived from the FAA or from maritime or New York law.

"[T]he task of an arbitrator is to interpret and enforce a contract, not to make public policy," he wrote. "Because the parties agreed their agreement was 'silent' in the sense that they had not reached any agreement on the issue of class arbitration, the arbitrators' proper task was to identify the rule of law that governs in that situation." *Id.* at 1767-1768.

Instead, the arbitration panel made a policy decision based on its view that there existed consensus in post-*Bazzle* arbitral decisions declaring class arbitration beneficial. The court pointed out, however, that *Bazzle* does not control because it left open the question of the standard to be applied when determining whether and under what circumstances class-wide arbitration may be permitted.

The court then turned to the mandate of the FAA, which is to "ensure that private agreements to arbitrate are enforced according to their terms" and to "give effect to the contractual rights and expectations of the parties." *Id.* at 1773-74 (citation omitted).

From this principle, the court said, "it follows that a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so." *Id.* at 1775.

The court noted that while there may be certain contexts in which to presume that parties entering into arbitration agreements implicitly authorize the arbitrator to adopt necessary procedures to give effect to the parties' agreement, class arbitration does not fall in this category.

Also, the court noted that the presumed benefits of arbitration, including lower costs, quickness and efficiency, are much less assured in class arbitration, which includes hundreds or thousands of parties, does not include the same presumption of privacy and confidentiality, and adjudicates the rights of absent parties. The court concluded, therefore, that, in the absence of explicit language, there is good reason to doubt the parties' mutual consent to resolve disputes through class-wide arbitration.

purported to preclude merchants from bringing or participating in class-wide actions regarding issues subject to arbitration.

Based on the arbitration provision, the U.S. District Court for the Southern District of New York granted Amex's motion to compel arbitration. *Id.* On appeal, the 2nd Circuit reversed. *See In re Am. Express Merchants' Litig.*, 554 F.3d 300 (2d Cir. 2009) *rev'd sub nom. Am. Express Co. v. Italian Colors Restaurant*.

"[T]he class-action waiver in the [agreement] cannot be enforced in this case because to do so would grant Amex de facto immunity from antitrust liability by removing the plaintiffs' only reasonably feasible means of recovery," the panel said. *Id.* at 320.

Amex sought review by the Supreme Court.

In its May 3 order vacating the judgment and remanding the case, the Supreme Court instructed the 2nd Circuit to reconsider the case in light of the decision in *Stolt-Nielsen*. Despite the Supreme Court's direct instruction, it is not entirely clear how the holding of *Stolt-Nielsen* would apply to *In re American Express*, where the parties had expressly agreed that class arbitration would not be allowed.

The Supreme Court's remand may be a signal to the 2nd Circuit that the principle espoused in *Stolt-Nielsen,* regarding arbitration agreements silent on the issue of class proceedings, should also be applied to arbitration agreements containing express class action waivers. Stated otherwise, if silent arbitration agreements must be read as precluding class-wide arbitration in accordance with the FAA, *a fortiori*, arbitration agreements that contain a ban on class proceedings should also be valid and enforceable under the FAA.

The defendants in *American Express* will surely make this argument, and on remand the 2nd Circuit will directly face the issue of whether class-action waivers in arbitration agreements are unconscionable simply because they prevent disputes from being resolved through class proceedings.

> The *Rent-A-Center* decision marked a sweep of three straight victories in the Supreme Court for proponents of arbitration.

The effects of Stolt-Nielsen

The effects of *Stolt-Nielsen* were felt almost immediately. In an order list published less than one week after the decision, the Supreme Court granted a writ of *certiorari* and vacated and remanded *American Express v. Italian Colors Restaurant* . The court directed the 2nd Circuit to reconsider its decision regarding the unenforceability of a class-action waiver in light of the *Stolt-Nielsen* opinion.

The *American Express* case began as a consolidated class action brought by merchants who contracted with American Express to accept its corporate, charge and credit cards. *See In re Am. Express Merchants' Litig.*, No. 03-CV-9592, 2006 WL 662341 (S.D.N.Y. March 16, 2006).

In the complaint, plaintiffs alleged that the merchant contract violated the Sherman Act. The merchant contract contained an arbitration provision that required all claims "arising from or relating to [the] agreement" to be resolved by arbitration. The contract also contained a class action waiver that

At a minimum, the *Stolt-Nielsen* decision should limit a growing practice among arbitrators of permitting class-wide arbitration despite "silent" arbitration agreements based on the presumed intent of the parties. Moreover, the post-*Bazzle* concern with the severability of class-action waivers may now be superseded, since *Stolt-Nielsen* appears to hold that unless an agreement can be read to permit class arbitration, it is not permissible under the FAA.

Stolt-Nielsen did not specifically address unconscionability arguments that are frequently raised in opposition to enforcement of class-action waivers in arbitration agreements. Nonetheless, parties will surely argue that *Stolt-Nielsen* preempts state law rulings refusing to enforce arbitration agreements with class-action waivers according to their terms pursuant to the FAA.

RENT-A-CENTER V. JACKSON

At the close of the term, the Supreme Court handed proponents of arbitration yet another victory in *Rent-A-Center v. Jackson*. The court held, in a 5-4 opinion authored by Justice Antonin Scalia, that the unconscionability challenge to the enforceability of the arbitration agreement was for the arbitrator to decide. The court's opinion sets the rules for determining the answer to who decides such challenges in future cases.

At issue in *Rent-A-Center* was a challenge by an employee resisting arbitration of a discrimination claim, arguing that the arbitration agreement he signed was unconscionable, and thus invalid. The court held that, where the parties have clearly agreed to delegate enforceability questions (including unconscionability questions) to the arbitrator, an unconscionability challenge to the arbitration agreement should be decided by the arbitrator — unless the challenge specifically targets the *delegation* as unconscionable.

The court's decision appears to resolve the conflict between the 9th Circuit, which held that basic questions of enforceability must be decided by a court, and the 8th and 11th circuits, which have held that a determination of enforceability may be delegated to the arbitrator. *Compare Jackson v. Rent-a-Center West*, 581 F.3d 912 (9th Cir. 2009), *with Terminix Int'l Co. v. Palmer Ranch L.P.*, 432

F.3d 1327, 1333 (11th Cir. 2005); *Sadler v. Green Tree Servicing,* 466 F.3d 623 (8th Cir. 2006). The court's ruling makes it more difficult for parties resisting arbitration to have their unconscionability arguments decided by the court, rather than by the arbitrator.

In 2007 Antonio Jackson was terminated from Rent-A-Center, and sued the company in federal district court, alleging that he was the victim of racial discrimination and that the arbitration agreement contained in his employment contract was unconscionable.

> In 2011, the Supreme Court will determine whether the federal arbitration law trumps state law contract limitations on class-action waivers.

The court granted Rent-A-Center's motion to dismiss and to compel arbitration under Section 4 of the FAA, which provides that courts must give full effect to valid arbitration agreements. The court held that because the agreement "clearly and unmistakably provides the arbitrator with the exclusive authority to decide whether the agreement to arbitrate is enforceable," the question of unconscionability must be decided by the arbitrator. *Jackson v. Rent-A-Center*, No. 03:07-CV-0050, 2007 WL 7030394 (D. Nev. June 7, 2007).

On appeal, the 9th Circuit reversed, holding that because an unconscionability challenge was a question of whether an agreement to arbitrate was valid in the first place, it was a threshold question of whether a party was even required to submit to arbitration and therefore a determination for the court. *Jackson*, 581 F.3d at 915-919. The Supreme Court granted *certiorari* and reversed.

Justice Scalia's opinion began with a discussion of contract principles applied to arbitration agreements, noting that the FAA "places arbitration agreements on an equal footing with other contracts" and that Section 2 of the FAA subjected arbitration agreements to general contract defenses. *Rent-A-Center,* 130 S. Ct. at 2776.

Addressing whether the delegation provision was valid under Section 2, the majority relied on the precedent addressing challenges to contracts with arbitration provisions, which distinguish between challenges to "the validity of the agreement" to arbitrate and "challenges to the contract as a whole." *Id.* at 2778 (*quoting Buckeye Check Cashing v. Cardegna*, 546 U.S. 440, 444 [2006]) [holding that a challenge to the validity of a service contract as a whole, not to the arbitration clause within it, must go to the arbitrator]).

The court held that "it makes no difference" whether an arbitration agreement within a contract or the arbitration agreement itself is at issue. *Id.* at 2779. Because Jackson did not raise a specific challenge to the arbitration agreement's concededly clear *delegation* of questions concerning the validity of the arbitration agreement to the arbitrator, his unconscionability attack on the arbitration provision must be decided by the arbitrator.

The *Rent-A-Center* decision marked a sweep of three straight victories in the Supreme Court for proponents of arbitration. The decisions will increase the ability of parties seeking to avoid class litigation by including individual arbitration provisions within agreements. On the whole, however, the three decisions in the 2009-2010 term were merely a prelude to 2011, when the Supreme Court will determine whether the FAA trumps state law contract limitations on class action waivers.

AT&T V. CONCEPCION: THE SHOWDOWN AHEAD

On May 2010 the Supreme Court granted *certiorari* in *AT&T Mobility v. Concepcion*, to address whether the FAA preempts state law rules limiting class-action waivers in arbitration agreements. The justices will consider whether the FAA preempts generally applicable state contract law principles such as unconscionability, an issue that could impact the scope of arbitration provisions nationwide.

In *Concepcion*, two customers filed a class action against AT&T Mobility, alleging various violations of consumer protection statutes. AT&T moved to compel individual arbitration pursuant to an arbitration agreement that contained an express class-action waiver.

The U.S. District Court for the Southern District of California denied the motion, holding that the arbitration agreement was unconscionable under California law because it contained a class action waiver. 407 F. Supp. 2d 1181 (S.D. Cal. 2005). California state courts have held that class action waivers are unenforceable as a matter of public policy.

On appeal, the 9th Circuit affirmed. *Laster v. AT&T Mobility*, 584 F.3d 849, 854-55 (9th Cir. 2009). It held that the class-action waiver was unconscionable because:

- It was contained within a contract of adhesion.
- The dispute involved small amounts of damages.
- The plaintiffs alleged a scheme to deliberately cheat large numbers of consumers out of small amounts of money.

AT&T filed a petition for a writ of *certiorari* on whether the FAA preempts states from conditioning the enforcement of an arbitration agreement on the availability of particular procedures, such as the availability of class actions. The Supreme Court granted review, and oral argument is scheduled for Nov. 9.

> A decision in *Concepcion* that federal law preempts state law unconscionability doctrines would have widespread implications in consumer and employment class actions.

CONCLUSION AND POTENTIAL IMPLICATIONS

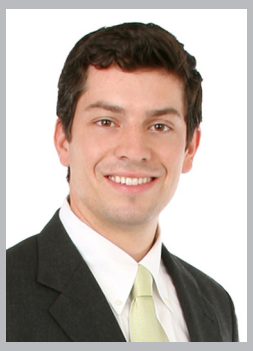
A decision by the Supreme Court in *Concepcion* that the FAA preempts state law unconscionability doctrines applied to class-action waivers would have widespread implications in consumer and employment class actions. Although no state goes as far as California in restricting the waivers, most state courts have had to consider unconscionability challenges to arbitration agreements, and to class action waivers in particular.

If the Supreme Court were to go further and issue a broad holding that the FAA preempts all generally applicable state contract law principles applied to arbitration agreements, the decision would overturn bodies of case law developed in every state. Under state law

principles of unconscionability, state courts have invalidated arbitration agreements for numerous reasons, such as limitations on remedies or contractual changes to the time period for bringing suit.

In recent years, the key focus of these disputes has been on whether class-action waivers are unconscionable, but the issues have touched virtually every term within arbitration agreements. Such a decision would also seem to allow drafters of these agreements (such as retailers, employers and financial institutions) to reinsert other types of provisions in arbitration agreements that state courts previously found to be unconscionable, such as limitations on remedies or non-mutual terms.

A decision by the Supreme Court that the FAA does not preempt state contract law would maintain the status quo on this issue, consistent with the holdings of most lower courts. Nevertheless, the *Stolt-Nielsen* and *Rent-A-Center* decisions have tilted Supreme Court jurisprudence further in favor of arbitration. WJ



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Lowe's

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$6.5 million in gift cards and cash plus $2.2 million in attorney fees.

Consumer advocates and others have criticized the agreement for offering consumers small payouts with high attorney fees.

Gift cards will range from $50 to $2,000, depending on how much documentation a consumer can provide. The maximum award of gift cards and cash is $4,500.

Georgia resident Glen Vereen sued Lowe's in June in Georgia's Muscogee County Superior Court on behalf of a nationwide class of consumers who bought drywall from the retailer.

The drywall allegedly emits sulfur dioxide and hydrogen sulfide, which corrodes electrical wiring and copper piping and causes a rotten-egg smell.

Hundreds of suits have been filed across the country over defective drywall from China. Vereen alleges that some of the problem drywall could be from domestic manufacturers as well.

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CRITICS SAY SETTLEMENT IS UNFAIR

Consumer advocates oppose the settlement, according to ProPublica, a nonprofit group of investigative journalists.

The $4,500 maximum payout does not come close to estimates established in other drywall litigation for the replacement and repair of homes and appliances, the group's website says.

In June a Florida jury awarded homeowners more than $2 million, estimating that repair costs alone would total $500,000. *Seifart et al. v. Banner Supply Co.*, No. 09-38887, *verdict returned* (Fla. Cir. Ct., 11th Jud. Cir., Miami-Dade County June 18, 2010) (see *Westlaw Journal Class Action*, Vol. 17, Iss. 6).

According to a ProPublica report, the Lowe's deal is a reversionary settlement, which allows the company to keep any money left after claims have been processed.

If claims do not reach the $6.5 million total, Lowe's would keep the difference. If the claims filed exceed $6.5 million, the amount each claimant could receive would shrink.

The attorney fees would remain at $2.2 million.

Attorneys in the federal multidistrict litigation over Chinese drywall, pending in the U.S. District Court for the Eastern District of Louisiana, have asked that court to block the settlement. *In re Chinese Manufactured Drywall Prods. Liab. Litig.* MDL No. 2047 (E.D. La.).

Lowe's is one of many defendants in the massive litigation.

Payments to consumers are too small and attorney fees are too high, the attorneys said, and the agreement "interferes with and erodes" the pending litigation. WJ

Related Court Documents:

Preliminary approval of settlement: 2010 WL 3198770
Settlement agreement: 2010 WL 3198718
Amended complaint: 2010 WL 3198717